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IN THE

Supreme Court of the United States

OCTOBER TERM 1967

No. 830

OSCAR GRUSS & SON,

Appellant,

—against—

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF OSCAR GRUSS & SON, APPELLANT, OPPOSING MOTIONS TO AFFIRM

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November 30, 1967

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The United States and the Interstate Commerce Commission (the "Commission"); The Pennsylvania Railroad Company ("Penn") and The New York Central Railroad Company ("Central"); and Richard Joyce Smith and William J. Kirk (the "New Haven Trustees"), Trustees of the property of The New York, New Haven and Hartford Railroad Company, Debtor ("the New Haven"), the defendants and intervening defendants in the action brought by Oscar Gruss & Son ("Gruss"), appellant, have filed motions to affirm in this matter.[1]

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[1] The motion of the United States and the Commission will be referred to herein as the "Government motion", that of Penn and Central as the "Penn-Central motion", and that of the New Haven Trustees as the "New Haven Trustees' motion". The Delaware and Hudson Railroad Corporation has filed a motion to affirm, captioned in this matter, among others, which takes no position with respect to this appeal.

Motions to affirm have also been filed by the State of Connecticut, the Commonwealth of Massachusetts, and the State of Rhode Island and Providence Plantations, and by the State of New York, which were not parties to the action brought by Gruss below.

On November 21, 1967, after the filing of the Jurisdictional Statement herein, the Commission served a Second Supplemental Report dated November 16, 1967 (the "November 1967 Report") with two orders dated November 16, 1967, based thereon, and filed the report and orders with this Court. The November 1967 Report purports to dispose of certain of the issues that were pending when the Jurisdictional Statement was prepared.

POINT I

Consummation of the merger of Penn and Central, without concurrent inclusion of the New Haven, would violate the Interstate Commerce Act.

The motions to affirm deal with the questions presented in the Gruss Jurisdictional Statement principally by evading, rather than answering, the arguments of Gruss, and by disregarding the facts on which the arguments are based.

A. The case of Gruss for reversal of the order below is based upon the following propositions:

1. Section 5 (2) (b) of the Interstate Commerce Act permits the Commission to approve and authorize a merger of two or more carriers, if and only if the Commission finds that, subject to such terms and conditions and modifications as it shall find to be just and reasonable, the proposed transactions will be consistent with the public interest.

2. Here the Commission has found that the merger of Penn and Central, without complete inclusion of the New Haven, would not be consistent with the public interest. 327 I.C.C. 475, 524.

3. The terms and conditions imposed on Penn and Central by the Commission provide no reasonable assurance that the New Haven will ever be included in the merged Penn-Central, and will certainly delay and probably prevent such inclusion.

The Penn-Central motion suggests (at pp. 11-14) that the Commission did not mean what it said when it found that "this merger, without complete inclusion of NH, would not be consistent with the public interest". (327 I.C.C. 475, 524) It is quite true, in the context of the prior discussion to which the Commission refers (327 I.C.C. at 522-4), that the Commission was concerned with inclusion of the New Haven's passenger operations as well as its freight operations. That does not alter the scope or meaning of the finding, or of the related finding that "inclusion of New Haven's freight and passenger operations in this transaction will be consistent with the public interest" (327 I.C.C. at 526-7).

The plight of the New Haven may not be the only reason for approving the merger of Penn and Central, but that is not the point. The point is that the Commission found that complete inclusion of the New Haven is essential, and that without such inclusion the merger of Penn and Central would not satisfy a basic requirement of the Interstate Commerce Act.

B. The New Haven Trustees' motion suggests that Gruss is seeking to delay the merger of Penn and Central

for "an extended period", until completion of proceedings for determination of inclusion terms under the Bankruptcy Act and the Interstate Commerce Act.

What Gruss is actually seeking is an interim procedure for actual inclusion of the New Haven operations in the merged Penn Central while the terms of sale are being finally determined. Terms of inclusion on an interim basis were suggested by Gruss to the Commission, after Penn and Central and the New Haven Trustees had failed to do so pursuant to the Commission order dated August 1, 1967. The delays to date have been caused by the intransigence of Penn and Central, the subservience of the New Haven Trustees to their wishes,[2] and the Commission's acquiescence in their defiance of the August 1 order.

C. The continued operation of the New Haven railroad by the New Haven Trustees, with or without a loan, is not inclusion of the New Haven in the Penn-Central merger, *de facto* or *de jure*.[3]

The basic concept of inclusion of the New Haven in the Penn-Central merger involves the conduct of the New Haven railroad operations by the merged company.

Inclusion of the New Haven in the merged Penn-Central can be accomplished in several ways including, but not

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[2] The New Haven Trustees are committed not to make any statement or file any document in the merger proceedings, or any judicial review thereof, inconsistent with the provisions and intent of their agreement with Penn and Central. See Gruss Application for Stay, Appendix B, p. 21.

[3] The use of the terms *"de facto* inclusion" and *"de jure* inclusion" appear in the New Haven Trustees' motion, at pp. 21 *et seq.* The Commission, the Government motion, and the Penn-Central motion all recognize that a loan is not inclusion, *de facto* or *de jure*.

limited to, a sale of all the New Haven properties to the merged Penn-Central:

> It could be accomplished, as proposed by Penn and Central in their brief filed with the Commission on June 1, 1964, by an operating agreement under which Penn-Central would operate the facilities of the New Haven without acquiring ownership thereof.[4] According to Penn and Central at that time, the coordination of operations through such an arrangement would produce savings which should not vary substantially from those to be accomplished by ownership of the line (approximately $5,200,000 per annum), would present less complications and depend on fewer contingencies than any other plan, and could be made effective more expeditiously.
>
> Inclusion of the New Haven in the merged Penn-Central could also be accomplished by a lease of the New Haven properties to the merged company. That method was suggested to the Commission in June and July 1967 by Gruss, other bondholder representatives, and the States of Connecticut, New York, Rhode Island, and Massachusetts. It is the method specifically adopted by the Commission in its order dated August 1, 1967. It is one of the two methods set forth in the supplemental complaint of Gruss herein.
>
> A third method of including the New Haven on an interim basis is a conveyance of the New Haven properties to the merged Penn-Central, subject to existing liens, and subject to a final determination of the amounts payable by Penn-Central and of the amounts payable to lienholders in the pending proceedings before the Commission and the Reorganization Court.

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[4] Brief of Penn and Central in the merger proceedings dated June 1, 1964, at pp. 123-4.

That method is specified in the complaint and supplemental complaint herein, and was suggested to the Commission in the Gruss petitions filed on July 11, 1966, and in applications and briefs filed thereafter.

Through any one of these methods, and perhaps others as well, it would have been feasible to provide for the actual inclusion of the New Haven in the merged Penn-Central, at the time of the merger and as a condition precedent to its consummation, without any delay whatsoever. It is still feasible without substantial delay.

Originally, when the Commission found that the Penn-Central merger without inclusion of the New Haven would not be consistent with the public interest, and required a commitment by Penn and Central to include the New Haven, the Commission contemplated that inclusion would have occurred before January 1, 1968 (November 1967 Report, at p. 102). It was the New Haven Trustees, perhaps under pressure from Penn and Central, who waited to file their first plan for inclusion and fragment of a plan of reorganization until the last day of the six-month period fixed by the Commission, and failed to file the rest of their plan of reorganization for another ten months. Bondholders have borne the losses incurred by the New Haven Trustees during that period, but cannot be charged with causing the delay.

It is now the Commission, at the instance of Penn, Central, and the New Haven Trustees, that is tolerating and causing further delay by abandoning its program for inclusion by lease pending reorganization of the New Haven and the sale of its assets.

As shown in Point II below, the Commission has not provided for the actual inclusion of the New Haven in the

merged Penn-Central. Since it has not done so, consummation of the merger should be enjoined. *Baltimore & Ohio R. Co.* v. *United States,* 386 U. S. 372 (1967).

D. The Government motion (at p. 21) and the Penn-Central motion (at p. 17) cite *R. F. C.* v. *Denver & R. G. W. R. Co.,* 328 U. S. 495, 535-6, for the proposition that the public interest in the continued operation of the New Haven would have to be considered on any application for dismissal of the reorganization proceedings.

The point we make is that the constitutional and statutory rights of bondholders must also be considered. The Commission has closed its eyes to those rights, which have thus far been continuously denied in order to keep the New Haven alive. What we seek is a proper balancing of the public interest with the rights of bondholders, as required by this Court in the *Denver & R. G.* case, *supra,* and in the cases cited at pages 24-5 of our Jurisdictional Statement.

Over two and a half years ago the Reorganization Court said (Gruss Application for Stay, Appendix C, pp. 24-5):

> "Far from being indifferent to the public interest, the court has indulged that interest and allowed it to prevail over the creditors' rights for three and one-half years.
>
> * * * * *
>
> "The creditors have borne the onus of the public interest long enough".

POINT II

The November 1967 Report of the Commission is inadequate to provide for inclusion of the New Haven in the Penn-Central merger, and leaves the merger without the essential statutory finding of consistency with the public interest.

A. The Commission has now abandoned the machinery set up in its August 1 order "designed", as it told the court below, "to produce operation of NH by the merged company at the time of consummation".

The November 1967 Report:

(1) Approves the inadequate price offered by Penn and Central for the New Haven properties, free of all liens;

(2) Approves consummation of the sale as a first step in a "plan of reorganization" to be consummated without any vote of bondholders;

(3) Authorizes consummation of the Penn-Central merger without concurrent inclusion of the New Haven operations; and

(4) Purports to authorize the New Haven Trustees to borrow up to $25 million from Penn-Central and to issue Trustees' certificates, in the amounts borrowed, with a first lien on all properties and earnings of the New Haven prior to the liens of all mortgages.

In a conscious attempt to force the bondholders into abandonment of their constitutional and statutory rights to vote on a plan, to know (when they vote) its impact

upon their claims, and to obtain court review of adverse rulings by the Commission,[5] the November 1967 Report would impose upon them a growing proportion of operating losses pending consummation of the sale, and the entire amount thereof if the Commission order is reversed and the New Haven liquidated.

The Commission is responsible for the delay that has already occurred between July 11, 1966, and November 21, 1967, in passing upon the issue of immediate inclusion. The Commission rejected the July 1966 petition of Gruss for a hearing, then objected to the standing of Gruss to obtain judicial review in the court below and in this Court, objected to taking the case on remand even after this Court's remand in May 1967, purported to require "steps for immediate inclusion of the New Haven into Penn-Central by lease" by its order dated August 1, 1967, reopened the question in its order dated September 12, 1967, and finally issued its adverse decision in the November 1967 Report, which now requires additional review proceedings.

B. The November 1967 Report of the Commission also sets the stage for further delay of any sale of the New Haven properties, free of liens, to Penn-Central. From October 1966, before the first filing of a fragment of a plan by the New Haven Trustees, until September 1967, when a complete plan was first filed, Gruss pressed for the filing of a complete plan by the New Haven Trustees. In *Chase Manhattan Bank* v. *Smith*, 328 F. 2d 635, 640 (May 29, 1967), the Court of Appeals for the Second Circuit noted that the time required to be spent in preparing an orthodox plan would hardly equal that needed to defend an un-

[5] Among other indications of the Commission's purpose is the statement in note 39, at p. 103: "we are making provision to ward off the possibility of undue litigation by the creditor groups as best we can."

orthodox one, not to speak of the later hazard of failure at the end of a long path of judicial review. The court below noted that the New Haven Trustees, as a result of those "adverse intimations" by the Court of Appeals, had abandoned their attempt to effect inclusion as a first step in a two-step plan of reorganization. Appendix to Jurisdictional Statement in No. 778, pp. B-23-24.

The November 1967 Report now invites the loss of time and hazard of failure against which the Court of Appeals warned. The Commission ignores both the majority opinion and the dissenting opinion in *St. Joe Paper Co.* v. *Atlantic Coastline R.R.*, 347 U. S. 298 (1954). Whichever of those two opinions may represent the law of the future, any sale of the New Haven to the merged Penn-Central would require at least its submission to a vote of bondholders. The Commission ignores also the admonition of this Court in *Palmer* v. *Massachusetts*, 308 U. S. 79, 88 (1939) that the enormous powers exercised by the Commission and the courts under Section 77 of the Bankruptcy Act can properly be exercised only in the context of "a complete plan of reorganization for an insolvent road." The attempt of the Commission to disregard the constitutional and procedural rights of the bondholders can only lead to additional delay.

C. The Commission has no power, in the light of its finding on public interest, to authorize the merger of Penn and Central on terms that do not provide reasonable assurance of the actual inclusion of the New Haven in the merged company.

The purported authority to issue Trustees' certificates will not, in fact, keep the New Haven alive for later inclusion in Penn-Central. Such certificates, under Section 77 (c)(3) of the Bankruptcy Act, can be authorized only by the Reorganization Court. Their issuance cannot properly

be authorized without a full hearing on the alternative proposed by the Committee, that the reorganization proceedings be dismissed and the railroad liquidated. *Bankers Trust Co.* v. *Gebhart,* 195 F. 2d 238 (2d Cir. 1952). The punitive terms proposed by the Commission, with the penalty increasing with each month of loss operations, is enough to ensure the determined opposition of bondholders and their representatives. There is and can be no assurance that the Trustees' certificates will actually be issued, and without them there is no provision made for continuance of the New Haven operations, their inclusion in Penn-Central, or compliance with the statutory requirement of consistency with the public interest.

D. Bondholder opposition is further assured by the Commission's gross undervaluation of the New Haven and its gross overvaluation of the consideration proposed to be paid by Penn and Central to the New Haven Trustees when the bondholders' liens are cancelled.

We recognize that this Court cannot now be asked to pass upon considerations of value. The fact that the Commission chose to make its decision while this appeal was pending compels us to discuss the matter only to show that the questions involved are serious, will cause further delay, and still leave the ultimate fate of the New Haven unsettled.

The Commission's entire discussion of asset values (November 1967 Report, pp. 22 to 63) is skewed by setting forth the contentions of the New Haven Trustees and of Penn and Central as though they were adversaries. The Commission glosses over the fact that both are proponents of the same price under the same agreement, and that the New Haven Trustees are committed not to make any statement

or sign any document inconsistent with the provisions and the intent thereof.

Perhaps the most shocking example of dealing with valuation evidence can be seen in the discussion of the Grand Central Terminal properties at pages 51-58. The properties themselves were valued by an expert witness for the New Haven Trustees at approximately $227 million, with indications on the record that this was an unduly low valuation. The contention of bondholders that approximately 40% to 50% of that value belongs to the New Haven is barely mentioned at page 57. The Commission then capitalizes a fraction of the net income derived from those properties at a figure of 8%, pulled out of the air; averages the $20 million so computed against the $5 million "nuisance value" self-servingly assigned to the New Haven interests by Central; and emerges with a finding of value of approximately $13 million.

Most of that $13 million disappears when the Commission, at page 63, jumps to the conclusion that the liquidation value of the New Haven assets to be conveyed to Penn-Central is "about $125 million as of December 31, 1966", although its findings of values up to that point add up to approximately $133,500,000.

The Commission makes two equally speculative leaps in valuing the consideration to be received by the New Haven Trustees.

The major portion of that consideration consists of 950,000 shares of Pennsylvania Railroad stock, listed on the New York Stock Exchange and selling at prices from 10⅛ to 65 during the ten years 1956-1965, from 40½ (in October) to 73⅜ (in February) for the year 1966, and from 52¼ to 70¾ for the year 1967, 54⅞ to 56 on November 27, 1967. At pages 64-65 the Commission capitalizes the com-

bined net income of Penn and Central in 1965 (when neither railroad was paying income taxes because of prior losses),[6] adds anticipated merger savings (without reference to income tax thereon), states that the trend in the market price of Penn stock is clearly "up" (ignoring the 20% decline in that market price since February 1966), and simply adopts the speculative figure of $87.50 a share used by the New Haven Trustees, which is over $25 per share (over $25 million) higher than the present market.

Even adding that unsupported guess at how the market will value the Penn stock at some unknown date (p. 69) to the other values to the New Haven of the proposed consideration ($37,500,000, according to the November 1967 Report at pp. 65-68) one gets a total of only $120,600,000. Yet somehow the Commission jumps to a finding of "approximately $125 million" for the consideration to be received from Penn-Central.

If the New Haven were actually to receive $125 million from Penn-Central today, $8 million (and all retained assets) would be consumed in contract adjustments and payment of current liabilities; $66 million would be offset by senior securities required to satisfy prior claims (mostly unpaid administration expenses) as of August 31, 1967; and the first mortgage bondholders would receive common stock in a reorganized company having a book value of

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[6] The combined consolidated net income of Penn and Central for 1965 was $124,316,000. For the first nine months of 1967 Penn reported consolidated earnings of $40,866,000, and Central reported a deficit of approximately $2,639,000. The November 1967 Report chooses to ignore those facts and the cyclical nature of railroad earnings. It adopts the position, which the Commission had correctly and emphatically rejected in 1966, that improved 1964 and 1965 incomes establish a trend toward permanent improvement in the finances of Penn and Central. 327 I.C.C. 475, 495-6 (April 6, 1966). (Cf. Motion of Penn and Central to Affirm in No. 835, pp. 13-14).

approximately $51 million, only 52% of their $98 million claim. Actually, the stock of the reorganized company would be worth less than $17 million, and that amount would be reduced as loss operations continue,[7] and would be further reduced if additional creditors (including Central)[8] establish their claims to priority.

The cost to Penn-Central is overstated by the Commission at $159 million, in large part by disregarding important values to be acquired by Penn-Central. On the Grand Central Terminal properties alone, worth upwards of $227 million, a fractional interest of 50% to 60% will be converted into 100% ownership. For income tax purposes, Penn-Central will acquire salable and depreciable properties which for tax purposes will have a basis approximately $130 million in excess of its cost to Penn-Central.

From the November 1967 Report (pp. 59-61) one would not even know that the evidence of tax advantages to Penn-Central (rejected by the Commission as "speculative") was presented by Mortimer S. Caplin, one of the leading tax experts in the United States, who served as Commissioner of Internal Revenue for over three years (Ex. NHI-105).

E. The cavalier treatment by the Commission, in the November 1967 Report, of the evidence presented and arguments made by bondholder representatives, and of the constitutional and statutory rights of bondholders, has as-

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[7] As of December 31, 1970, according to an exhibit submitted by the New Haven Trustees, claims ahead of the bondholders will have increased from $66 million to $86 million.

[8] Central is among the creditors, with claims aggregating approximately $5 million, who have appealed from a Reorganization Court order denying their asserted priority as six-months claimants.

sured further delay and probable frustation of any inclusion of the New Haven operations in the merged Penn-Central.

The Commission's approval of consummation of the merger, without concurrent inclusion of the New Haven, violates the basic requirements of the Interstate Commerce Act.

It was irrelevant for the Court below, in dismissing Gruss' complaint, to remark that the Commission had given "every indication of its intention" to prescribe some form of financial aid that will permit the New Haven's operations to continue beyond December 31, 1967 (Appendix to Jurisdictional Statement in No. 778, at p. B-29). Such an intention, whether laudable or not, does not satisfy the standards of Section 5 (2) of the Interstate Commerce Act.

Gruss, and other bondholder representatives, will promptly seek review of the Commission orders based on the November 1967 Report. Such review will, however, be futile if consummation of the Penn-Central merger is permitted before the review proceedings are terminated.

The order of the district court should be reversed. The case should be remanded to that court with instructions to restrain consummation of the merger of Penn and Central until the operations of the New Haven are included in the merged Penn-Central at least on an interim

basis, whether by lease or otherwise, pending completion of the New Haven's reorganization proceedings.

Respectfully submitted,

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